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No. 91-1677

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS

The Pension Benefit Guaranty Corporation ("PBGC") is the federal government corporation charged by Congress with administering and enforcing Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), including the pension plan termination insurance program. *See* 29 U.S.C. §§ 1301-1461. The PBGC guarantees retirement benefits for more than 40 million Americans covered by defined benefit pension plans. *See gen-*

erally Nachman Corp. v. PBGC, 446 U.S. 359 (1980).[1] PBGC's guarantees are triggered when a defined benefit plan terminates without enough assets to pay vested benefits. The money to pay for those guarantees comes from the premiums assessed against all sponsors of PBGC-insured pension plans. Despite large increases in the premium rates since PBGC was created in 1974, PBGC's deficit has been growing and now stands at $2.5 billion. 1991 PBGC Annual Report at 1.

To keep the PBGC's deficit from ballooning further and to ensure the continued viability of this government insurance program, PBGC is vigilant about possible pension abuses. *See, e.g., PBGC v. LTV Corp.*, 496 U.S. 633 (1990). Because PBGC believes the Fifth Circuit's decision invites serious pension-funding abuse, we support the Solicitor General's petition on behalf of the Commissioner of Internal Revenue for a writ of certiorari to the Court of Appeals for the Fifth Circuit.[2]

[1] Defined benefit plans provide retirees a fixed amount per month based on factors such as final salary and years of service. Such plans differ from defined contribution plans (also known as individual account plans), under which employers typically contribute a percentage of an employee's compensation to an account, and the employee is entitled to the account upon retirement. *See* 29 U.S.C. § 1002(34) and (35).

[2] Rule 37.5 of the Rules of this Court authorizes the filing of a brief *amicus curiae*, without the consent of the parties, "on behalf of any agency of the United States authorized by law to appear on its own behalf when submitted by the agency's authorized legal representative." The PBGC has such legal authority, pursuant to 29 U.S.C. § 1302(b)(1), and has previously filed briefs as *amicus curiae* with the Court. *See, e.g., Mead Corp. v. Tilley*, 490 U.S. 714, 716 (1989); *Carpenters Pension Trust for Southern Cal. v. Shelter Framing Corp.*, 467 U.S. 1257 (1984).

REASONS FOR GRANTING THE WRIT

This case concerns whether a pension plan sponsor may make non-cash contributions to a defined benefit pension plan, in satisfaction of the sponsor's funding obligations, without violating the *per se* prohibited transaction rules. Those rules, contained both in ERISA and in the Internal Revenue Code, are explicit and were enacted to protect pension plan participants and beneficiaries from transactions thought to be highly susceptible to abuse. *See Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 636-637 (W.D. Wis. 1979); *Leib v. Commissioner*, 88 T.C. 1474, 1481 (1987). The Fifth Circuit upheld the Tax Court's holding that, under 26 U.S.C. § 4975(c), contributions of property, rather than cash, may be used to satisfy funding obligations due a defined benefit plan, without regard to the statutory protections governing "prohibited transactions." PBGC agrees with the Commissioner of Internal Revenue that the Fifth Circuit's holding is wrong. We believe the correct view is set forth in the Fourth Circuit's recent decision in *Wood v. Commissioner*, 955 F.2d 908 (4th Cir. 1992), which directly conflicts with the holding in the instant case.[3]

The Fifth Circuit's holding is contrary to the longstanding position of the Department of Labor expressed in its advisory opinions that a non-cash con-

[3] A petition for a writ of certiorari was filed in the *Wood* case on April 14, 1992. 60 U.S.L.W. 3745 (U.S. April 14, 1992) (No. 91-1645). As *Wood* raises the same issue as this case, PBGC urges the Court to consider the two cases together. The facts in *Wood* illustrate the potential for abuse even more clearly than the facts of this case. *See infra* at 8. The Fourth Circuit's decision in *Wood* should therefore be affirmed.

tribution of property to discharge a plan sponsor's legal obligation to make pension contributions is a prohibited transaction. Dep't of Lab. Advisory Op. 81-69A, 1981 ERISA LEXIS 24 (July 28, 1981); Dep't of Lab. Advisory Op. 90-05A, 1990 ERISA LEXIS 5 (March 29, 1990). And in allowing these kinds of contributions, the Fifth Circuit failed to consider the overall statutory scheme dealing with prohibited transactions. PBGC agrees, in particular, with the Fourth Circuit's comment in *Wood* that the prohibited transaction provisions of 26 U.S.C. § 4975 should not be construed narrowly because they are "part of a remedial scheme designed to protect the retirement security of plan participants and beneficiaries by prohibiting certain types of transactions which are particularly subject to abuse." 955 F.2d at 914.

The position taken by the Fourth Circuit in *Wood* does not absolutely bar non-cash contributions to a defined benefit pension plan.[4] Although such contributions would generally constitute prohibited transactions under 26 U.S.C. § 4975(c) and 29 U.S.C. § 1106(a), the parallel provision of ERISA, these statutes permit limited contributions of non-cash property if the transaction falls within a statutory exemption, *see* 26 U.S.C. § 4975(d); 29 U.S.C. § 1108, or if the contributing sponsor obtains an administrative exemption from the Department of Labor, *see* 26 U.S.C. § 4975(c)(2).[5] Section 1108(a) of Title 29

[4] Nor would it absolutely bar such contributions to a defined contribution plan. We focus on defined benefit plans, however, because they are the only kind of pension plans insured by PBGC and the kind at issue in the present case.

[5] The Department of Labor administers Title I of ERISA, containing 29 U.S.C. §§ 1106 and 1108, and also has primary

permits the Secretary of Labor to grant an exemption from the prohibited transaction rules if the exemption is (1) administratively feasible, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of the plan. 29 U.S.C. § 1108(a).

In administering these provisions, the Department of Labor seeks to ensure, among other protective conditions, that the transaction is for "adequate consideration." *See, e.g.*, 29 C.F.R. § 2570.34(b)(5)(iii) (1991) (exemption applications must contain appraisals or market analyses); Grant of Individual Exemption: Pan American World Airways, Inc. Cooperative Retirement Income Plan, 54 Fed. Reg. 32,534, 32,536 (1989).[6] This, in turn, requires that the property be valued fairly, which protects participants and beneficiaries and, ultimately, PBGC's insurance program.

In the absence of these protections, allowing non-cash contributions in satisfaction of a plan sponsor's statutory funding obligation creates a tremendous potential for abuse. When non-cash contributions are made to a pension plan, the plan sponsor is generally the party valuing those contributions. And a plan sponsor, especially one experiencing financial difficulties, may have an incentive to inflate the value placed on contributed property. In PBGC's experience, the value placed on non-cash property at the time of con-

authority to construe 26 U.S.C. § 4975. *See* Reorg. Plan No. 4 of 1978, 3 C.F.R. 332 (1978), *reprinted in* 5 U.S.C. app. at 1374 (1988), *and in* 92 Stat. 3790 (1978).

[6] Likewise, the statutory exemptions to the prohibited transaction rules require, *inter alia*, "adequate consideration." *See* 29 U.S.C. § 1108(e)(1).

tribution often exceeds the value realized on the property after the pension plan terminates and PBGC becomes plan trustee.

Contribution of overvalued non-cash property by a pension plan sponsor may disguise the fact that the sponsor is having trouble funding its plan. This is harmful in several ways. Not only are the required cash contributions not made, but because participants continue to accrue benefits, PBGC's possible losses increase as the pension plan becomes more underfunded. The statutory protections against underfunding (excise taxes, 26 U.S.C. § 4971, and funding suits, 29 U.S.C. § 1132(a)(5), (b)(1)) cannot be brought to bear and PBGC cannot make an informed decision about whether to terminate the plan.[7]

If in such a case the plan sponsor's business prospects do not improve, PBGC's potential losses become actual losses when the pension plan terminates. Moreover, because the level of benefits guaranteed by PBGC is limited, *see* 29 U.S.C. § 1322; 29 C.F.R. Part 2621 (1991), the participants and beneficiaries of the plan may suffer losess if the plan is underfunded due to a contribution of overvalued property.

Plan sponsors have generally complied with Department of Labor advisory opinions 81-69A and 90-05A; accordingly, the PBGC has not yet come across a large number of cases where non-cash contributions were made to defined benefit pension plans. However, in those cases where such contributions were made, the PBGC has often suffered substantial losses.

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[7] Section 1342(a) of Title 29 gives the PBGC authority to initiate plan termination in response to, *inter alia*, a failure to fund or to prevent the agency's potential losses from increasing unreasonably.

In one case, for example, a financially troubled plan sponsor contributed to its pension plans shares of its own non-marketable stock, in lieu of cash, to satisfy a $26 million funding obligation. The plan sponsor valued the stock at $26 million. When the plan sponsor subsequently filed for bankruptcy, it terminated its plans, which were underfunded by more than $550 million. PBGC thereafter filed suit against the plan trustee who accepted the stock at the inflated value, asserting, among other things, that the stock contribution was a prohibited transaction because it was not for "adequate consideration." As successor trustee of the by-then terminated pension plans, the agency sought to recover losses to the plans from this transaction of approximately $35 million (the estimated amount the plans lost on the improper transaction). And in pursuing the plan trustee, PBGC relied on the Department of Labor advisory opinions cited above that interpreted 29 U.S.C. § 1106, the ERISA parallel to 26 U.S.C. § 4975, to prohibit such non-cash contributions.

In the midst of settlement negotiations in that case, the Tax Court issued its opinion in *Wood*. 95 T.C. 364 (1990). The opinion was used against the PBGC because it rejected the rationale of the Department of Labor's advisory opinions and held that non-cash minimum funding contributions were not prohibited transactions. PBGC subsequently settled the case for $5 million, which it believed at the time, and still believes, was a reasonable settlement; however, the settlement covered only a small portion of PBGC's total loss from this transaction. Participants also lost $55 to $60 million of benefits not guaranteed by PBGC as a result of the plans' underfunding at termination.

In another recent termination, PBGC learned that the only contribution ever made to the pension plan of a now-bankrupt plan sponsor was a piece of real property. There are approximately $1.4 million in benefits due plan participants. Although the land was valued at $2 million by the plan sponsor at the time it was contributed in the early 1980's, it now has an estimated market value of only $350,000. While real estate market values have declined in the interim, it nonetheless appears that the original contribution was significantly overvalued. PBGC's funds must now be used to make up the plan's shortfall.

Finally, the *Wood* case, in which the Fourth Circuit held that a contribution of non-cash property was a prohibited transaction, provides further evidence of the potential for abuse. 955 F.2d 908, *petition for cert. filed*, 60 U.S.L.W. 3745 (U.S. April 14, 1992) (No. 91-1645). The minimum funding obligation for the year in question was $114,000. *Id.* at 909. Rather than contribute that amount in cash, the plan sponsor contributed promissory notes with a face value of $114,000. *Id.* The market value of the notes, however, was only $94,430. *Id.* at 910. The plan therefore actually received $20,000 less than required by the minimum funding rules.

These examples illustrate how non-cash contributions to a defined benefit pension plan can harm the participants, the plan and the PBGC. Because the potential for abuse is so great when non-cash property is used to satisfy funding obligations, PBGC strongly supports a blanket prohibition on such transactions, unless the contribution satisfies a statutory exemption or the plan sponsor obtains an administrative exemption from the Department of Labor permitting such a contribution. PBGC believes that this is what

Congress intended when it enacted the prohibited transaction provisions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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